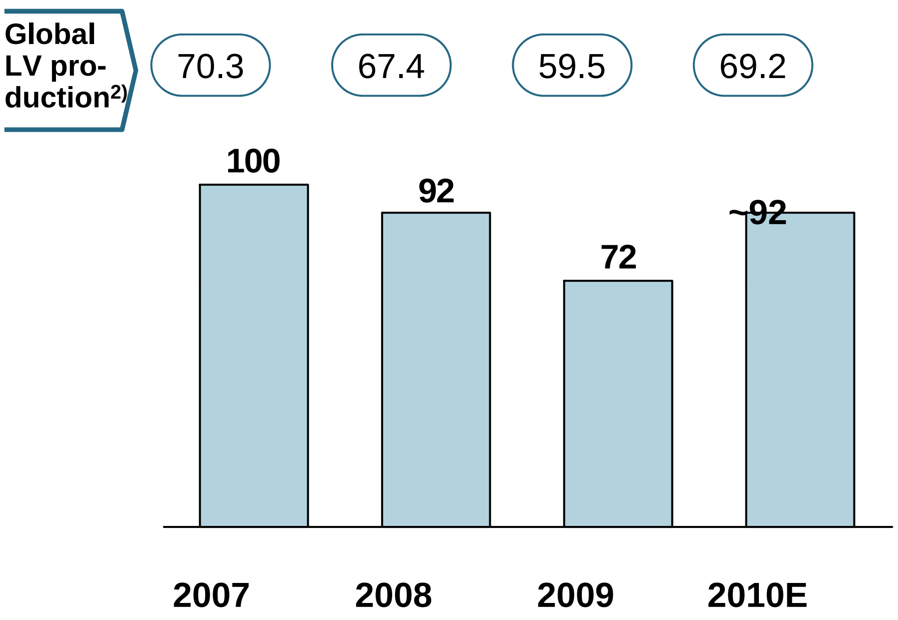
Chinese automotive market: How long will the party last?

Shanghai/Munich, December 2010

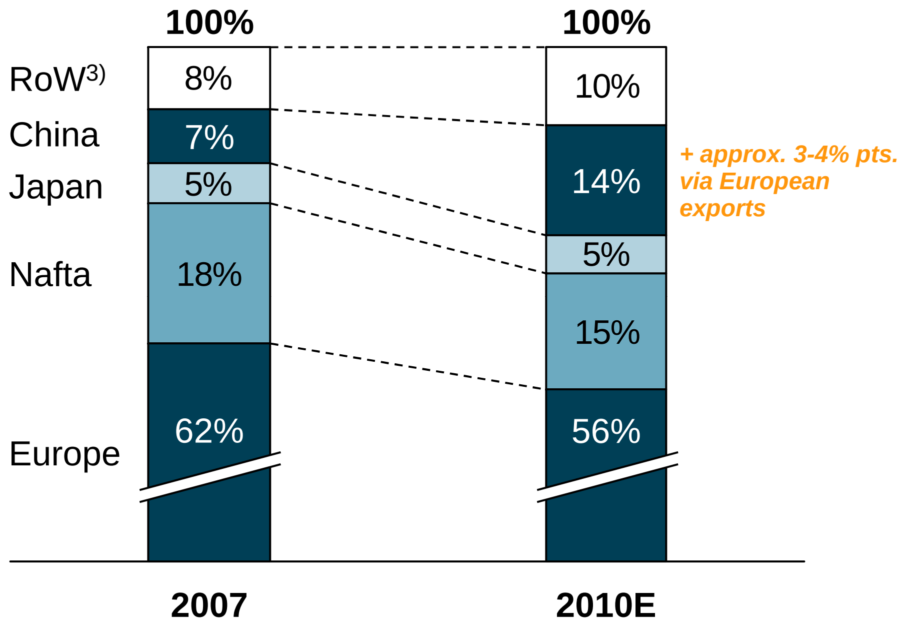
Roland Berger Strategy Consultants

Global revenues of European auto suppliers are almost back at pre-crisis levels. Almost 20% of supplier revenues now depend on China

Revenue development of typical European auto supplier [Index: 2007 = 100][1)]



Revenue structure of typical European auto supplier by parts delivery region



Approx. 18% of total revenues of a typical European supplier depend on market development in China

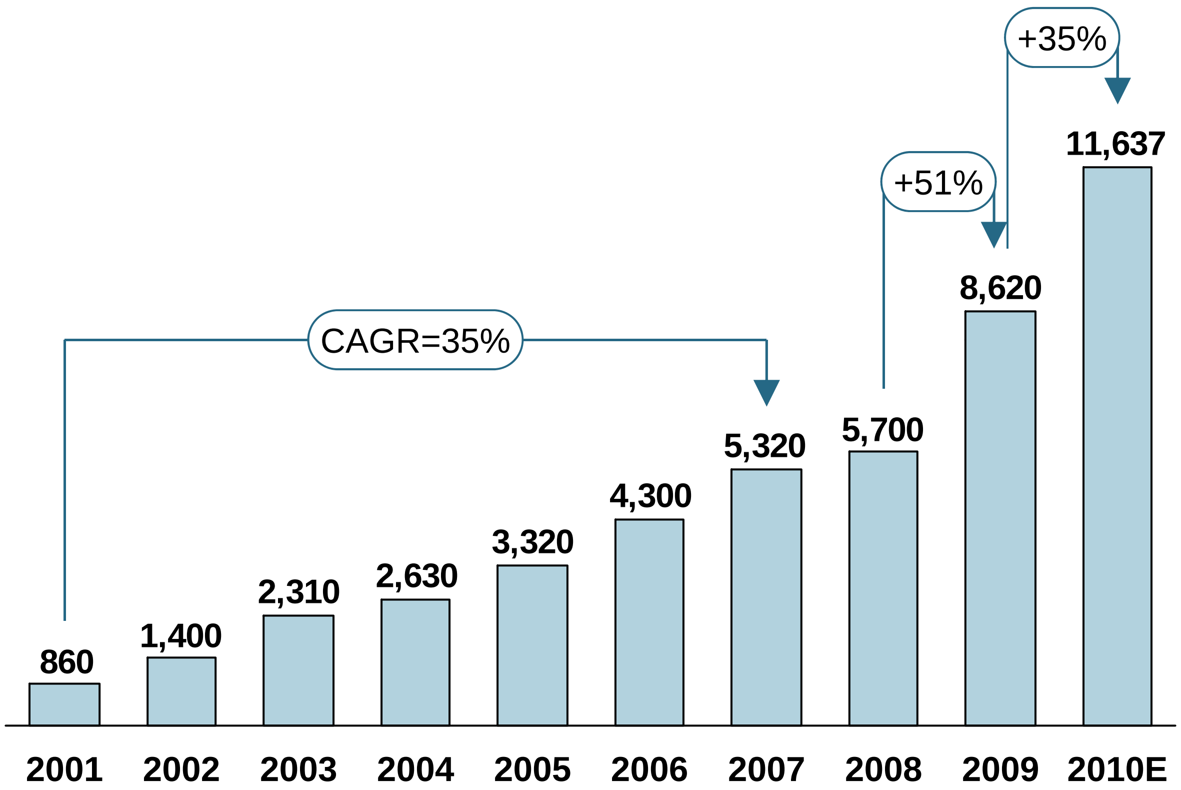
1) Basis: ~100 Western European suppliers 2) Light vehicles in m units
3) Rest of World – Including Brazil, India, etc.

Source: Roland Berger supplier database

Roland Berger Strategy Consultants

After a decade of strong growth, the Chinese market for passenger cars will exceed 11 m units in 2010

China passenger vehicle (PV) sales, 2001-2010E ['000 units]



Comments

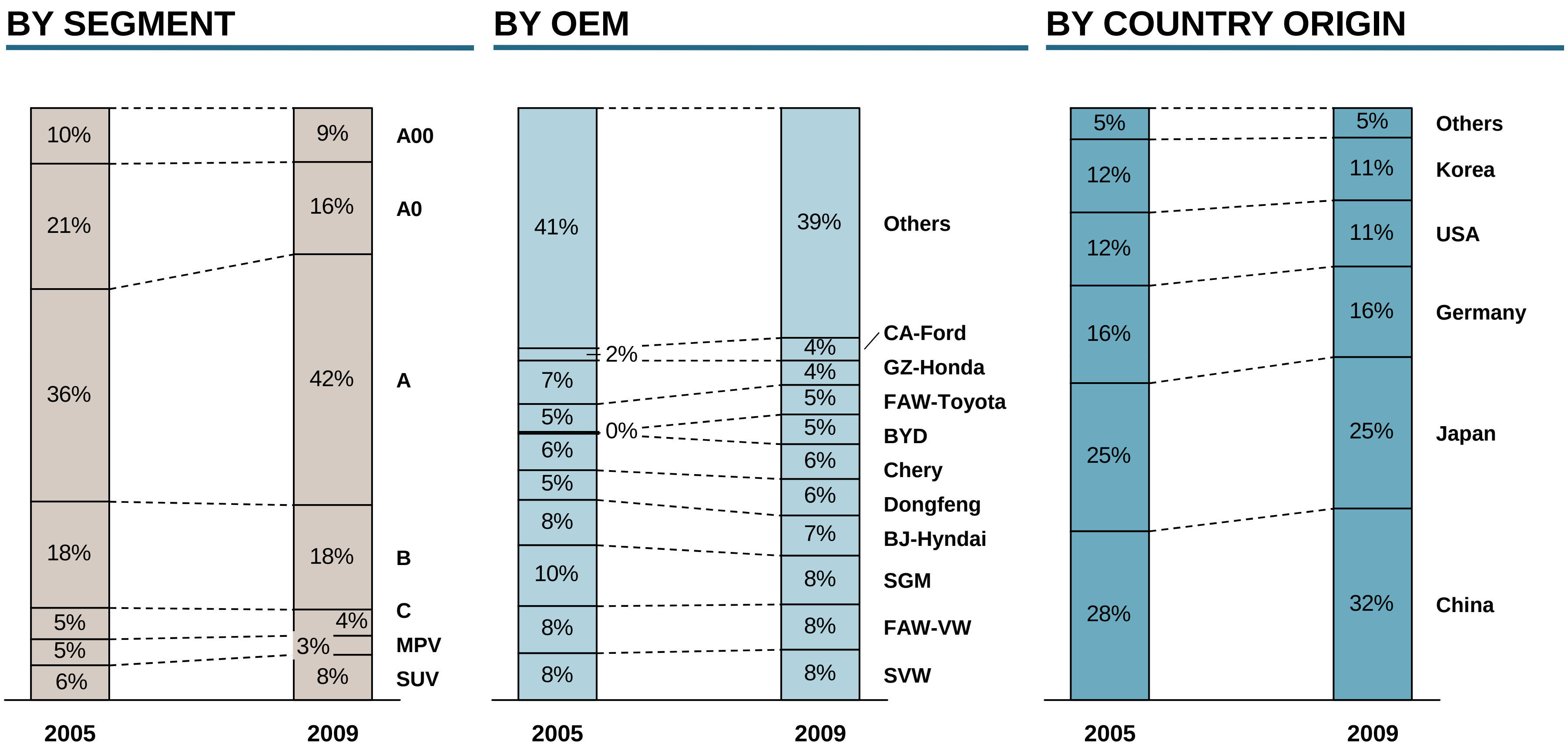
- China PV market had experienced strong growth of 35% p.a. from 2001 to 2007, mainly driven by the booming **private automobile consumption**
- PV market growth had slowed down in 2008, due to the global **economic crisis**
- **Government stimulus** plan for automotive consumption triggered fast recovering growth at ~50% in 2009

Source: China Association of Automotive Manufacturers (CAAM); China State Information Center | Roland Berger

Roland Berger Strategy Consultants

Market shares by vehicle segment, by OEM brand and by country of origin remained relatively constant during that period

Chinese PV market structure 2009 vs. 2005

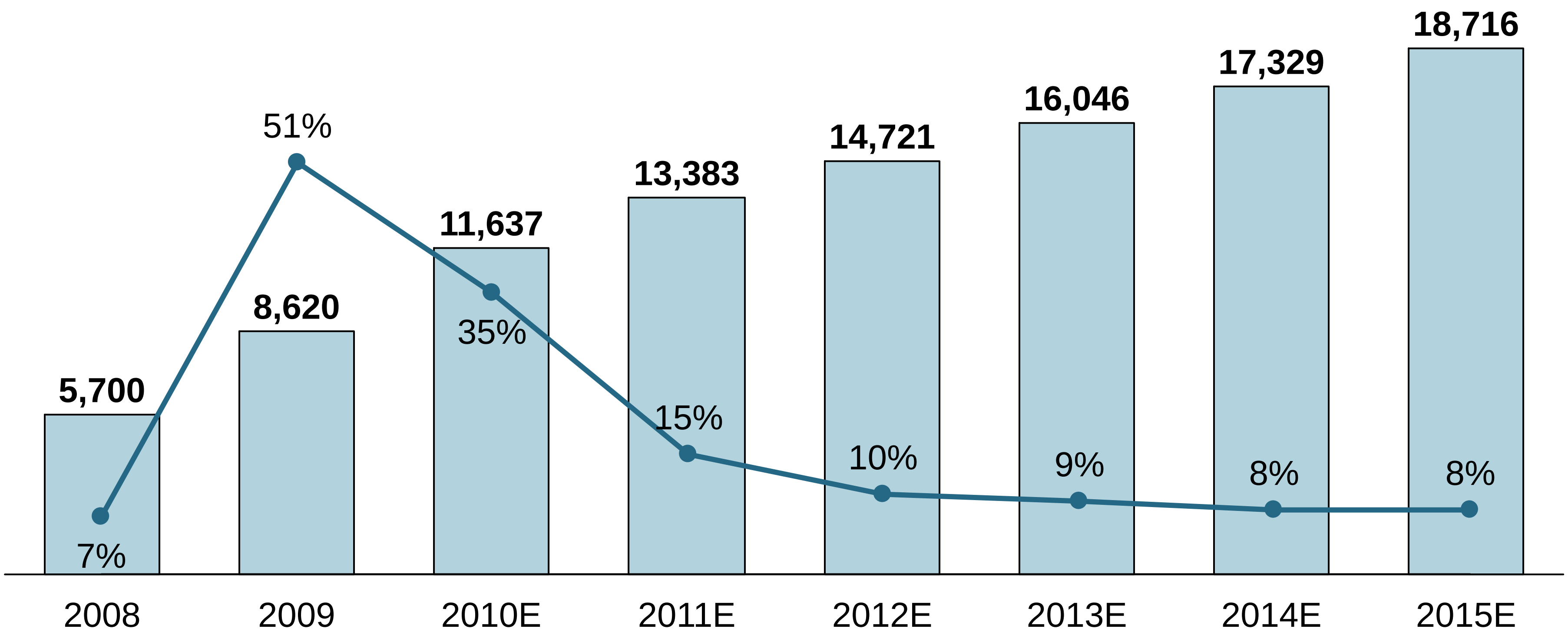


Source: CAAM; Roland Berger analysis

Roland Berger Strategy Consultants

According to our forecast, PV sales in China will exceed 18m units by 2015. BUT: GROWTH RATES WILL DECLINE SUBSTANTIALLY

China PV sales, 2010E-2015E ['000 units] and annual growth rate [%]



Notes: Third party forecast in 2015: CSM 16.0 million units; DRC 14.4 million units; JD Power: 13.6 million units
1) DRC: Development Research Center (DRC) of the State Council

Source: CAAM; China State Information Center (SIC); Roland Berger analysis

Roland Berger Strategy Consultants

Fast GDP growth and rising household disposable income will be the two main drivers for the car market development

Major drivers of future PV market development

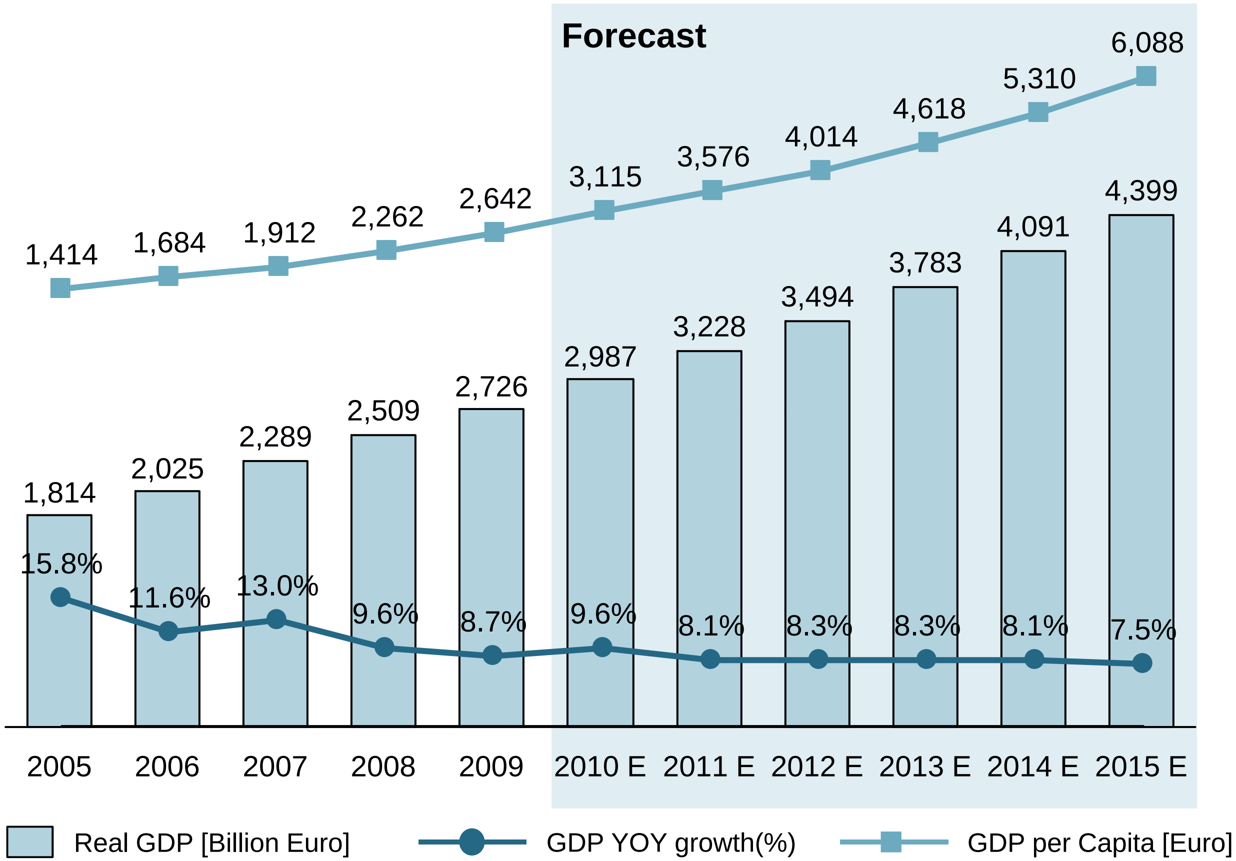
			Notes	Trend (10-15)
Private Consumption	Enlarging population for car consumption	**Rising household disposable income**	PDI grew by 10.4% annually since 2005	Up
		Fast urbanization	Urbanization rate increases by 1.2% annually since 2000	Up
	More choices at affordable prices	Speed up of new model launch by OEM	221 new models of PV were launched in 2009 (face-lift included)	Flat
		Retail price drop due to competition	PV retail price keeps an annual drop of 5.2% since 2001	Up
		Government stimulus program	From 2009, consumer tax has been lowered for models of 1.6L and below, and car replacement compensation has been announced	Down
	Increasing infrastructure/ service readiness	Fast growing high-grade roads/highway	Length of high way reached 60.3 K KM in 2009, triple as that of 2001	Up
		Development of auto fin. and used car services	Auto consumption loan increased by ~20% in 2009	Up
Business Usage	**Fast GDP growth**	Strong fixed asset Investment/FDI	An RMB 4,000 bn economic stimulus program was launched in 2009	Down
		Strong export growth in the past	CAGR=24.6% (2001-2008), decreased by 11.2% in 2009 due to the economic crisis	Flat

Source: Roland Berger

Roland Berger Strategy Consultants

China's economy is still expected to experience attractive growth in the next years…

China GDP growth forecast



Comments

Chinese growth has been supported by massive stimulus, but this has aggravated existing imbalances, which will slow down the GDP growth in the coming years

- **Export** growth is slowing down due to currency inflation
- **Investment** will reduce after the economy stimulation policies went over
- **Consumption** increase will be impacted by the real estate bubble

Source: EIU; Roland Berger analysis

Roland Berger
Strategy Consultants

… despite some significant challenges ahead

Risk factors in China's future economic growth

1	CURRENCY APPRECIATION	The appreciation of RMB will dwarf China's export, which is one of the key pillars behind strong economic growth.
2	GOVERNMENT STIMULUS PACKAGE	Right after the financial crisis, China launched an RMB 4,000 bn economic stimulus program, which greatly boost the economic recovery. But this stimulus plan can not be sustained.
3	MONETARY POLICY	China economy growth now driven by aggressive fiscal policy plus moderately relaxed monetary policy. In fear of inflation and real estate bubble, monetary policy might be tightened
4	UNEMPLOYMENT	The unemployment ratio of China is around 10% in 2009, which is quite high. If this not well managed by the authority, the concern of social unrest might intensify
5	LABOR COST	Rising labor cost, together with the appreciation of the currency, may hurt the competitiveness of China export and dwarf FDI, which will lead to a slow down in economic growth

- Despite the risk factors, the overall Chinese economy is still **funda-mentally stable**
- So far the Chinese **government** has been quite successful in managing the challenges of an appreciating currency, rising labor cost, and slowing down export, etc.
- According to our analysis, unless there is major social unrest or turmoil (which is not very likely), a sustained economy growth is foreseeable, though at **a bit lower speed** than that in the previous years

Source: Roland Berger

Roland Berger
Strategy Consultants

Three main implications for Western auto suppliers

1 Volume planning

- Passenger car market **almost doubles** between 2008 and 2010
- But: growth rates will be **significantly lower** in the next years (this trend is already visible in the past few months). China will not save supplier's business in 2011)

Plan 2011+ volumes very cautiously and based on multiple scenarios

2 Localization impact

- OEMs shifting more and more **production capacity** directly to China
- Strong pressure from OEMs to **localize parts production** (localization rate increasing by 3-5% p.a.)
- As a consequence, delivery volumes in **Europe** are getting under pressure

Carefully study potential impact from further increase in localized parts supply

3 Business model

- Changes in **cost structures** (increasing labor cost) and **exchange rates** make parts exports from China less attractive
- Continued **upgrade** of skill-set and R&D capacity in China (trend towards higher value-added activities)

Revisit current business model for Chinese operations

Source: Roland Berger